



CHINA'S NEW ECONOMIC STRATEGY: DEFINING THE U. S. ROLE

INTRODUCTION

In a remarkable speech this January, Communist Party Chief Hu Yaobang admitted that the government of the People's Republic of China (PRC) had "wasted 20 years" because of "radical leftist nonsense" associated with the policies of Mao Zedong and the Gang of Four. Hu attributed China's turmoil during the period of the Great Leap Forward through the Cultural Revolution (1958-1976) to the Party's trying to solve economic problems with radical slogans such as "better to have socialist weeds than capitalist seedlings."¹

Hu's candid public remarks confirmed officially what all Chinese certainly have known for years (and what foreign boosters of Mao's China refused to admit)--that the Chinese communist economy was a shambles. Shortly after Mao's death, horror stories about the PRC economy began pouring out of Beijing. The problems, documented in a number of studies by Chinese economists and widely advertised by post-Mao politicians, stemmed primarily from the quality of economic performance rather than of production, although quantity per capita was also exceptionally low. By the time Deng Xiaoping asserted his authority in 1978, the PRC economy was "like a cancer-stricken patient in urgent need of therapy."² Three matters badly needed attention: (1) the ills plaguing the economy had to be identified; (2) the causes of those ills had to be diagnosed; and (3) remedies had to be prescribed and applied.

Among the specific ills to be identified were the misallocation of resources, poor quality, structural imbalances between

¹ New York Times, February 21, 1985, p. A7.

² Ramon Myers, "How Well Did American Economists Understand Communist China's Economy?" Issues and Studies, November 1984.

the various sectors, underemployment, excessive subsidies, poor technological improvement, and low levels of per capita income.

The Chinese found the causes more difficult to recognize, because socialist economic theory offered few tools to analyze structural deficiencies within a state-planned system. By 1979, however, some Chinese economists were cautiously blaming the economic system itself and urging reform instead of mere adjustment.

The remedies prescribed and applied have been subject to intense internal debate within the PRC. Essentially, the argument has raged between those advocating policy adjustments within the state-planned system and those arguing for reform of the economic system. Although the initial remedies were in the form of adjustments, later policies have reflected some structural changes in the system.

The far-reaching nature of these structural changes made a strong conservative backlash inevitable. Too many communist cadres found their privileged positions eroded. And too many tenets of Party doctrine were cast aside in the march toward economic modernization. As the reforms proceed, opposition is likely to mount.

The modernization of China along rational economic lines is extremely important to the U.S. If present trends continue and structural reform of the PRC economy occurs, U.S. relations with China may become qualitatively better than the current relationship of expedience entered into for largely strategic--anti-Soviet--reasons.

The U.S. should encourage the development of a private sector and market economy in China. At the same time, Americans must maintain a cautious assessment of the reforms' long-term prospects. The program may fail in the end. And the help the U.S. extends to Beijing today may be used against America's friends and interests in the future.

ILLS OF THE PRC ECONOMY

The PRC's major economic ills have been reflected in a number of symptoms. Among them:

1. Massive misallocations of resources. This resulted in: shortages of some goods and services while others were in surplus; high inventory levels; and long construction cycles that tied down scarce fixed capital.

2. Poor quality of inputs. While the rate of investment rose steadily over the years, the effectiveness of this investment steadily declined. There was, in other words, growth without productivity gains. Between 1952 and 1977, agricultural producti-

vity declined significantly. Industrial productivity began to fall in the early 1970s. Raw materials utilization rates were among the highest in the world, with the pampered heavy industry being the worst offender.

3. Poor quality of outputs. Producer and consumer goods and services have been of low quality.

4. Structural imbalance. Heavy industry grew very fast compared with light (consumer goods) industry, transportation, and agriculture. Within heavy industry, machinery output grew faster than the growth of the energy needed to run the machines. As a result, much industrial capacity was idle over extended periods of time.

5. Unpredictability. The economy was subject to violent, unpredictable swings. The biggest of these, the post-Great Leap Forward depression (1960-1962), brought in its train an absolute drop in population of 13 million.

6. Widespread underemployment. This plagued both agriculture and industry.

7. Excessive price subsidies. Over 30 percent of essential goods, especially foods produced by inefficient agricultural practices, were subsidized, imposing a heavy drain on the state budget. In 1979-1981, subsidies absorbed close to one-third of government budgetary revenues. Subsidies also artificially suppressed inflation. Along with the permanent shortage of goods, these created a permanent sellers' market for most goods and services.

8. Sluggish innovation and diffusion of modern technology. Between 1957 and 1978, China's technological lag behind the industrialized countries seriously widened. The corps of scientists, engineers, technicians, managers, and other professional experts was meager even by the standards of developing countries.

9. Low per capita income. In 1979, per capita gross national product (GNP) was \$253, in the same range as that of Kenya or Sudan. One-third of the rural production teams (the basic farming unit at that time) had a yearly per capita net income of less than \$65. Officially designated basic subsistence in rural areas required an annual per capita income of \$75. This meant that, after more than two decades of rural collectivization, as many as 300 million Chinese existed below the subsistence level. In 1978, 80 percent of peasant expenditures went for food and clothing--almost no change since 1952. Between 1962 and 1980 the annual rate of growth of foodgrains per capita was 0.4 percent. Between 1963 and 1978, average industrial wages fell by at least 20 percent in real terms. There had been no general increase in urban money wages for 20 years, while prices of nonstaple commodities had mounted substantially.

CAUSES OF THE PROBLEMS

Identifying causes for the poor condition of the PRC economy proved difficult for China's experts, because Marxist economic philosophy was of no help in diagnosis.

The search for causes proceeded in two stages. The first (1976-1979) was dominated by political housecleaning and ideological score settling. All the economy's disabilities were blamed on the erroneous, ultraleftist machinations of the Gang of Four--as Mao's wife Jiang Qing and her three allies derisively came to be known. Later, Mao's own policy mistakes after 1957 also were targeted for blame. This approach implied that there was nothing wrong with the PRC's basic economic system that a change in personnel and in "style of work" could not fix. China's economic ills were thought to be due to incorrect policies, deviations from proper socialist conduct, and the cannibalization of economic institutions by recurrent mass campaigns. China's economic problems, in other words, were to be found not in the socialist model of command (central) planning but in the defective use of the model.

One difficulty with this diagnosis was that other communist economies were suffering identical ills, although none of them had endured the policy errors of Mao and the Gang of Four. All of them, however, had their origins in the same Stalinist plan. This prompted the more perceptive Chinese economists in 1979 and 1980 to conclude that the chief cause of China's economic ills was not the defective application of the socialist model, but the structure of the centrally planned economy borrowed from the Soviets.

Such discovery was fraught with peril because it implicitly but unavoidably questioned the very foundations and essence of the socialist economic system. In Marxist-Leninist terms, the discovery was more than merely revisionist; it bordered on the counterrevolutionary.

Despite the negative implications for socialism, the idea that the main source of China's economic troubles lay in its adoption of the Soviet economic system began to take hold in 1979. Permeating theoretical discussion, the idea increasingly found expression in muted calls for reform of the system itself, rather than mere adjustment of policies.

REMEDIES

PRC leaders recognized that, conceptually, there were two kinds of remedies to correct the economic ills that had been identified in the post-Mao years.

The first remedy consisted of intrasystemic changes. These were, in essence, policy changes or "adjustments" that could be

far-reaching but did not alter the institutional structure of the centrally planned economy. Operationally, possible such adjustments were: a) administrative reorganization and reshuffling of goal priorities, and b) borrowing various techniques from market systems and using them as supplements to the central plan. Using capitalist techniques to build socialism is of course based on the assumption that the use of markets and private property is separable from the pluralistic economic culture and ethical system within which they were conceived.

The second type of remedy consisted of reforms that address the institutional structure and principles of the basic economic system. Such reforms change the plan to the point where market relations and de facto private property rights become the system's dominant organizational arrangements--in other words, they involve the marketization and privatization of command. Allocative decision-making power is vested in consumers and producers directly linked by competitive market transactions. The transactions are voluntary, based on the maximization of profits by producers and of satisfactions by consumers, both calculated by reference to flexible market prices. Reform, then, is intersystemic change--in Marxist terms, "capitalist restoration."³ The plan is decentralized in an economic sense.

Policy Adopted

Having arrived at the controversial conclusion that the key to China's economic ills was its Soviet-type economic system, China's leaders had to select remedies. Evidence suggests that they began with adjustments, but then experimented with systemic reforms on a significant but limited front under controlled conditions.

Organizationally, there were two important adjustments: 1) the rebuilding of the central planning apparatus of ministries and bureaus, which had been decimated by the Cultural Revolution, and 2) the restoration of township administrations in the countryside, which had been eliminated by force during the communization during the Great Leap Forward.

Many of these adjustments were cosmetic. The economic and party bureaucrats, battered down during the Cultural Revolution, were put back in place. An effort was made to rejuvenate them through the retirement of the more senescent members and to assure their loyalty through "rectification" or ideological retraining. But many cadres have balked at cooperating with the modernization effort or with any adjustment measures that even remotely smacked of reform.

³ The conceptual distinction between adjustment and reform of the plan is discussed at length in Jan S. Prybyla, The Bird in the Cage: Market and Plan Under Socialism (forthcoming).

Adjustment also included changes in the ranking of society's goals. Given the collapse of the incentive structure under Mao's egalitarian "iron pot" policies and the resulting low per capita income levels in agriculture, it made sense from the standpoint of political survival for the communist leadership to raise consumption from a bottom priority to somewhere near first place.

The prestige of consumer goods relative to producer goods accordingly was raised. Further, it was decided--although not very successfully executed--to reduce the rate of investment from over 30 percent of GNP to around 25 percent. Foreign capitalist investors and traders were allowed to make money in China, and the PRC's self-imposed isolation from outside technology was ended.

There was no intention, however, to democratize China's politics. At best, efforts were made to rid it of the worst Maoist excesses. The political order intentionally remained monistic, dictatorial, and repressive and firmly under the control of the Chinese Communist Party.

Rural Production Responsibility

A more portentous set of adjustment remedies applied some capitalist techniques to the hitherto communized agriculture. It was thought these would revitalize the countryside without infecting it with the capitalist virus. The adjustment began in 1979 in the less prosperous parts of the country after having been first tried successfully in Deng Xiaoping's native Sichuan province. Called "production responsibility," the plan was applied first to groups and then to households. It boosted production, productivity, and peasant earnings. It is an arrangement under which the production team (the basic unit of PRC production and accounting) contracts with small groups or individual families for the delivery to the team of specified produce at state-set prices.

In the first type of contract, used principally in 1979, the production team assigns collectively owned land to small groups of four to six households for one to three years with a specified output delivery. Typically, the groups do the field work, while the production team supplies draft animals, chemical fertilizers, and other inputs. Surplus is kept by the groups and is distributed by them among their members.

The second type of contract is almost identical with the first, except that land and draft animals are assigned to, and the accounting is made with, individual peasant families. Usually the households retain all surplus over the delivery contract and can dispose of it at will. This arrangement was used most frequently in 1980.

Both types of contracts had been used in China during collectivization in 1956 and in the wake of the Great Leap disaster in 1961-1965. Both represent policy adjustments rather than reform.

A third type of contract, appearing in 1981, however, could lead to systemic reform if carried to its logical conclusion. Under the farming contract with households (baogan daohu), individual families contract with production teams to deliver given quantities of produce at state-set prices. Families are assigned parcels of land according to the number of their able-bodied members. While the legal title to the land remains collective, extensive use rights are vested in the private family unit for fifteen to twenty years. This is a system of disguised tenancy, the landlord being the state. After fulfilling its contract and being paid for it in money or goods, the family can grow what it chooses and dispose of the surplus in any way it wants. This includes consumption on the spot, sales in village and urban free markets, or sales to the state at "negotiated" prices, which approximate free market prices. This system of contracts represents a significant privatization of property and partial marketization of production and exchange relations in the countryside. Contractual quotas, taxes, and communal levies apart, the private family unit becomes the autonomous production and income distribution unit. The bulk of transactions becomes voluntarized and is carried out at competitive market prices.

The Logic of Remedy by Reform

Marketization and privatization have an internal logic that makes it essential for the process to continue and expand once it is set in motion. The history of the agricultural contract system illustrates this. The one to three year lease of land to households gave rise to underinvestment and an abusive use of land. After all, there is little incentive for a family to invest in a landholding that in a year or so will pass to someone else. This disincentive forced Beijing to extend the term of the leases under baogan daohu to fifteen to twenty years.

It was the same story with draft animals. Rotating them among households resulted in animals that were overworked and underfed. The response was to permit peasant families to own livestock. Today 90 percent of draft animals in China are owned privately by peasant households. Because there were similar difficulties with the collective tractors, their ownership was made private. Peasants also eventually were allowed to purchase trucks or to use their tractors for transportation. In time, some households began to specialize in transportation and machinery repair. Many such specialized households have come into being in farm-related activities (poultry raising, grain production, fish breeding), services (farm machinery operations), and manufacturing and processing of goods (furniture, clothing, construction materials, food processing).

These specialized occupations and township-run mini-industries have provided employment for the large numbers of workers who no longer are needed to till the land because of the responsibility system's increased farm productivity. Collective workshops, meanwhile, have been rented to family cooperatives or individuals, who run them more efficiently than did the township bureaucrats.

To achieve economies of scale, land parcels assigned to individual households can now be consolidated. Compensation is made for investments improving the productivity of the land. Some family tenant farms are now as large as 150 acres, and a family with such a farm is allowed to hire a limited number of workers to help with farm operations.

Investment in land and in private business requires credit. As such, credit and marketing cooperatives now thrive.

There is no doubt that the pace of marketization and privatization in the countryside has accelerated since the early 1980s and that its scope has expanded. While conditions vary from place to place, it is clear that in this sector of the economy adjustment is near to, if it has not already crossed, systemic borders.

To a significant extent, China's agriculture has been freed from the fetters of a centrally planned economy. The results have been spectacular in terms of production, productivity, and per capita income. Since 1978, rural per capita income has risen almost 250 percent. Grain output has increased from 280 million tons in 1977 to 400 million tons in 1983. Roughly one-third of rural labor has been released for other tasks and absorbed into mostly private or private-cooperative service and manufacturing operations. Moreover, the average rural diet has improved.

Premier Zhao Ziyang announced this year that the state gradually would cease being the only purchaser of key agricultural products. Disappearing with this will be the last vestiges of state quotas and pricing in the agricultural sector.⁴ This, again, is a logical outcome of the marketizing and privatizing process initiated in 1979. As a result of this process, output increased to the point where quotas are not needed; more is being offered than the state can handle, and in some instances, the state-set quota price is higher than the market-determined price for the same products. Under the new system, family farmers are no longer guaranteed a basic income from quota sales to the state, but they gain greater latitude in decision making. They can branch out into production lines dictated by their own perception of the market situation. They take the risks, and they reap the benefits.

Warning Signals

These agricultural changes succeeded because of the enlarged role of markets and de facto private property rights in the countryside. But these changes, while appreciated by the more

⁴ The contents of Document No. 1 may be found in Inside China Mainland (Taipei), May 1984, pp 1-8. The Zhao announcement is in Beijing Review, January 7, 1985, p. 15.

successful households and supported by the present leadership, deeply offend many others. These include: the less successful peasants, who formerly benefited from the common iron pot without breaking their backs; the middle-level bureaucrats who have lost their former prestige and authority; the ideological purists who view with alarm the emerging income and class differentiation in the countryside and the abandonment of key principles of socialist ethics; sections of the army, which have difficulty obtaining new recruits now that more money is to be made in the countryside; and those administrators in charge of such collective infrastructures and public goods as irrigation and drainage systems, education, and public health, who have trouble collecting from the peasants the fees needed to finance these projects.

Even within the top leadership, many powerful party and army officials view rural marketization and privatization with misgivings. A loose alliance of conservatives and radicals is forming around the conviction that Deng's marketization and privatization policies have gone too far too fast. They fear that capitalist techniques cannot be divorced from the political, cultural, social, and ethical environment of the economy. Encouraged by high-ranking officials expressing second thoughts, some petty cadres are obstructing the Dengist changes. Reports abound of money-making peasants being harrassed and of confiscatory levies and surtaxes being imposed on prosperous families by envious and ideologically hostile local autocrats.

These reactions could trigger yet another of the policy adjustment cycles endemic since the establishment of the PRC: relaxation of controls leading to dislocations; dislocations leading to tightening of controls; tight controls leading to stagnation; and stagnation leading to relaxation. PRC history cautions against regarding any set of changes as irreversible--including the rural production responsibility system.

EXTENDING THE CHANGES TO INDUSTRY AND COMMERCE

The PRC Central Committee announced last October that the broad principles of the rural production responsibility system are to be extended to industry and commerce from 1985 to 1989.⁵ The Committee proposed:

--The scope of mandatory planning at the central and provincial levels is to be reduced and replaced by minimum planning for

⁵ "Decision of the Central Committee of the Communist Party of China on Reform of the Economic Structure." Adopted by the 12th Central Committee at its Third Plenary Session on October 20, 1984. Beijing Review, October 29, 1984, pp. I-XVI. For an analysis of this document: Jan S. Prybyla, "The Chinese Economy: Adjustment of the System or Systemic Reform?" Asian Survey, forthcoming May 1985.

guidance and by the operation of the market. Mandatory planning will be retained only for key commodities, such as energy, steel, large machinery, some raw materials, basic farm produce, and armaments.

--The scope of state-set prices is to be reduced, and that of prices floating between state-set maximums and minimums and free market prices is to be enlarged.

--The allocation of key commodities to specific users is to be reduced and replaced by greater commercialization of wholesale supply channels.

--State ownership of firms is to be separated from their management. The right of management to hire and dismiss labor is to be enlarged, as is the right to allocate after-tax profits and basic wage determination.⁶ It is likely, however, that managers will continue to be appointed by party and government authorities.

Although these reforms represent a significant marketization and privatization of industry and commerce, the process of liberalization will be controlled. A sudden freeing of prices is out of the question, for it would ignite inflation. Eventually, the marketization of the price system has to extend to wages and interest (price of capital) and include the scarcity price of land (rent). Though this will require sweeping changes unprecedented for the PRC, a comprehensive price reform of wholesale and retail prices is essential if China's economic modernization is to succeed.

Reforming PRC industry and commerce will be difficult. The changes involved affect the highly bureaucratized state sector of the economy at the central and provincial levels. Opposition to granting firms expanded decision-making responsibilities will come not only from the supervisory bureaucracies, but from the many managers who thrive within the existing system. They have little knowledge of, and less inclination for, competitive market behavior, economic risk taking, and entrepreneurship.

There are major differences between agricultural and industrial reform. In agriculture, the success of the responsibility system has been due to the decentralization of allocative decisions to the level of the private family. In industry and commerce, the basic decision-making unit under the proposed changes will still be social: the state or collective enterprise with managers appointed by and responsible to administrative and party superiors. In agriculture, a market for a variety of products has existed for years. This has not been the case in industry and urban commerce. Most transactions were made at artificially set prices. Therefore, it would seem that the chances for realization of

⁶ Beijing Review, June 18, 1984, pp. 10-11.

reform in industry and commerce are slimmer than they were in agriculture. Chances of a successful reform are slimmer still.

CONCLUSION

What began as minor repair of the PRC's socialist economic system savaged by the radicalism of the Cultural Revolution has developed through the internal logic of the process into a serious attempt to restructure China's Soviet-type command economy. Marketization and privatization have advanced most in agriculture, albeit against determined opposition from sections of the party and bureaucracy. In this sector, systemic reform truly has begun.

Extending the rural changes to the urban industrial and commercial sector will prove far more difficult, because it involves the marketization of the present industrial wholesale and retail price system and a significant broadening of decision-making powers to local enterprises. Reform of urban industry and commerce requires a sharp reduction in the powers of the state and party economic bureaucracies. It calls for the mobility of labor and capital. Many bureaucratic managers are not willing or able to accept this level of privatization.

While the economic obstacles in the way of systemic reform are serious, the greatest danger comes from politics. Using capitalist techniques to build socialism is not a politically, ideologically, or ethically neutral question. Marketization and privatization of the institutional structure of the economy involve pluralization of decision-making, leading to the creation of competing power bases in society.

Preventing the spread of pluralization from economics to other areas of China's polity surely will be resisted fiercely by many party and bureaucracy officials. China's socialist history is characterized by violent swings from left to right and back again. Reversal on short notice of what appeared to be permanent changes has occurred repeatedly. Deng's current policies may be no different. Indeed, because they are so ideologically and economically unorthodox and because they invade jealously guarded political turfs, reaction against them is likely to be powerful. The reformist intent even may be strangled quietly by uncooperative cadres at all levels.

The experience of Hungary and Yugoslavia suggests that half measures do not resolve the kind of qualitative ills that centrally planned economies exhibit. In fact, a bit of market discipline and a dash of privatized property rights mixed in with a lot of bureaucratic planning and administrative controls make matters worse. There is no such thing as market socialism, if "socialism" means a centralized economic plan. Systemic reform cannot be limited to a single sector, but must apply to the entire, integrated institutional structure of the planned economy. While not

inconceivable if the present leadership survives Deng's succession, the likelihood of such complete reform in China is small. Still, the PRC's central administrative command planning is so manifestly crippled that remedy would appear possible only by systemic reform in the direction of markets and private property.

U.S. interests are deeply involved with China's modernization. At stake are significant commercial interests as well as strategic, political, and ideological considerations. It is in the U.S. interest that China's economy be market-oriented, that its domestic and international policies contribute to regional stability, and that its government and people eschew the excesses of Maoism.

This is a process that Washington should encourage and assist through practical economic exchanges with the PRC. But U.S. trade and assistance policy should be based upon realistic assessment of Beijing's ability to succeed with economic modernizations. Undue optimism is not warranted. Indeed, such optimism may be harmful to the extent that the mirage of China's potential distracts Americans from the advantages of maintaining close ties with traditional U.S. friends and allies in the region, particularly the Republic of China on Taiwan.

Caution is dictated by the fact that, if economic modernizations succeeds, Beijing will become another serious competitor to U.S. business at home and abroad. The PRC similarly will be a stronger challenger to U.S. interests in East Asia. If the PRC reforms fail, then a more radical communist government could emerge that might move closer to Moscow or stir up trouble in Southeast Asia or in the Taiwan Straits.

In short, while the U.S. should cooperate with China's modernization, it should be prepared to maximize long-term U.S. benefits and minimize potential risks. This policy must be worked out in consultation with Congress and concerned segments of the American public.

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